



Ballot gains - March 2017 Newsletter

Favourable political outcome drive markets higher

At the outset, let us remind our readers that but for highly uncertain situation arising until a few weeks into de-monetisation last November, we had turned constructive towards re-investing in Indian equities. However, just like other market participants, we too had not bargained for the stupendous election results favouring the ruling BJP. This coupled with weakening dollar and the risks arising on the reflation trade in US has led to a reversal in FII flows into Indian markets. And with an already existing stream of domestic inflows, it creates a perfect base for a buy-on-correction market. This is slightly more positive stance compared to what we stood for before, both due to positive institutional flows as well as impact of remonetisation.

But expect challenges ahead

Index valuations at 1-year forward P/E of 18x, is at 25% premium over historic averages. Moreover, mid cap indices are trading at slight premium to the benchmark large cap indices. Going ahead, Q4 results should once again reflect the economic reality and monsoon forecasts due late April will gain more significance than ever. But the good news is that the much awaited GST reform is closer to being reality. Even though the market returns and stock-level alpha generation will be more hard fought from here on (a bit like India's recent cricket series victory over Australia!), we would still argue for a directionally positive trend over the coming year, peppered with some volatility in the near term.

Commercial real estate – multiple ways to build exposure

Real estate has been one of the worst performing sectors in the Indian market this decade. While residential recovery has some macro enabling factors in place now (viz. lower interest rates), the demand pick-up might be restricted to affordable housing segments (led by the recent sops) thus offering limited opportunities in the listed space. We therefore focus on commercial real estate where a relatively broader recovery has been underway for some time now.

India's office market had witnessed an all-time high annual absorption of over 43 million sq. ft. in 2016, registering a growth of nine per cent on a y-o-y basis. Sustained occupier interest led to stability in quarterly office space leasing, with demand rising by about 20% on a q-o-q basis. Commercial rental market is likely to rise anywhere between 5 and 12 per cent due to limited supply and average vacancy has been coming down since 2013. The demand for office space is outstripping supply especially in markets like Pune, Bengaluru, Chennai and Hyderabad. This is therefore leading to a continual downward pressure on vacancies and an upward pressure on office rental yields in these markets.

Given the tight supply conditions, we expect accelerated demand in the commercial real estate space. As such, the way to play this would be through the following segments

1. Rent yielding assets, which can be monetised through sale to financial investors or a eventual REIT listing (Prestige, Phoenix Mills)
2. Central Air-conditioning providers (Voltas, Blue Star)
3. Plywood and interior Engineering Procurement & Construction (EPC) business, both of which are provided by Uniply, a national player with proven credentials in a otherwise fragmented industry
4. Power genset manufacturers, mostly for back up requirements (Cummins, KOEL)